NATIONAL HEALTHCARE CORP
Form 10-Q
November 08, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to ____________

Commission file

number
001–13489

(Exact name of registrant as specified in its Charter)

Delaware	52–2057472
(State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)

100 E. Vine Street
Murfreesboro, TN

37130
(Address of principal executive offices)
(Zip Code)

(615) 890–2020
Registrant's telephone number, including area code

Indicate by check mark whether the registrant: (1) Has filed all reports required to be filed by Section 13 or 15(d), of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S–T (§232.405 of this chapter) during the preceding 12 months (or for such period that the registrant was required to submit and post such files).

Yes [x] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer [X]	Accelerated filer [ ]
Non–accelerated filer (Do not check if a smaller reporting company) [ ]	Smaller reporting company [ ]

Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

Indicate by check mark whether the registrant is a shell company (as is defined in Rule 12b–2 of the Exchange Act). Yes [ ] No [x]

15,233,254 shares of common stock of the registrant were outstanding as of November 7, 2018.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Operations

(in thousands, except share and per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017 *(as adjusted)*	2018	2017 *(as adjusted)*
Revenues:				
Net patient revenues	$234,827	$229,259	$697,173	$683,598
Other revenues	11,499	11,937	34,256	34,831
Net operating revenues	246,326	241,196	731,429	718,429
Cost and expenses:				
Salaries, wages and benefits	149,188	145,900	434,749	426,639
Other operating	64,507	63,250	192,268	188,522
Facility rent	10,190	10,106	30,691	30,273
Depreciation and amortization	10,437	10,833	31,176	31,609
Interest	1,170	1,322	3,663	3,599
Total costs and expenses	235,492	231,411	692,547	680,642
Income from operations	10,834	9,785	38,882	37,787
Other income:				
Non–operating income	8,467	6,090	11,056	16,047
Unrealized gains on marketable equity securities	3,486	–	417	–
Income before income taxes	22,787	15,875	50,355	53,834
Income tax provision	(1,700)	(4,691)	(9,792)	(19,448)
Net income	21,087	11,184	40,563	34,386
Net loss attributable to noncontrolling interest	55	168	249	349
	$21,142	$11,352	$40,812	$34,735

Net income attributable to National HealthCare Corporation				
Earnings per share attributable to National HealthCare Corporation stockholders:				
Basic	$1.39	$0.75	$2.68	$2.29
Diluted	$1.39	$0.75	$2.68	$2.28
Weighted average common shares outstanding:				
Basic	15,225,654	15,195,394	15,221,217	15,186,315
Diluted	15,242,086	15,220,567	15,230,692	15,217,797
Dividends declared per common share	$0.50	$0.48	$1.48	$1.41

The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.

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NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Comprehensive Income

(unaudited – in thousands)

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017	2018	2017
Net income	$21,087	$11,184	$40,563	$34,386
Other comprehensive gain (loss):				
Unrealized gains (losses) on investments in restricted marketable debt securities	(180)	397	(3,772)	2,629
Unrealized gains (losses) on investments in marketable equity securities	–	(4,373)	–	5,751
Reclassification adjustment for realized (gains) losses on sale of securities	7	(17)	(18)	(255)
Income tax benefit (expense) related to items of other comprehensive income	36	1,572	795	(3,074)
Other comprehensive gain (loss), net of tax	(137)	(2,421)	(2,995)	5,051
Net loss attributable to noncontrolling interest	55	168	249	349
Comprehensive income attributable to National HealthCare Corporation	$21,005	$8,931	$37,817	$39,786

The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.

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NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Balance Sheets

(in thousands)

	September 30, 2018 *unaudited*	December 31, 2017
Assets		
Current Assets:		
Cash and cash equivalents	$55,599	$59,118
Restricted cash and cash equivalents, current portion	10,209	6,397
Marketable equity securities	139,502	139,085
Restricted marketable debt securities, current portion	17,606	21,012
Accounts receivable, net	87,263	86,767
Inventories	7,590	7,153
Prepaid expenses and other assets	3,163	2,864
Notes receivable, current portion	1,338	1,450
Federal income tax receivable	2,203	5,465
Total current assets	324,473	329,311
Property and Equipment:		
Property and equipment, at cost	977,373	958,748
Accumulated depreciation and amortization	(436,437)	(409,429)
Net property and equipment	540,936	549,319
Other Assets:		
Restricted cash and cash equivalents, less current portion	1,925	1,906
Restricted marketable debt securities, less current portion	150,428	145,383
Deposits and other assets	5,807	4,867
Goodwill	20,995	17,600
Notes receivable, less current portion	10,031	11,801
Investments in limited liability companies	30,073	36,339
Total other assets	219,259	217,896
Total assets	$1,084,668	$1,096,526

The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.

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NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Balance Sheets (continued)

(in thousands, except share and per share amounts)

	September 30, 2018 *unaudited*	December 31, 2017
Liabilities and Stockholders' Equity		
Current Liabilities:		
Trade accounts payable	$19,611	$15,978
Capital lease obligations, current portion	3,865	3,696
Accrued payroll	58,487	67,102
Amounts due to third party payors	17,596	17,389
Accrued risk reserves, current portion	27,815	27,409
Other current liabilities	16,561	16,194
Dividends payable	7,613	7,297
Total current liabilities	151,548	155,065
Long–term debt	75,000	100,000
Capital lease obligations, less current portion	20,132	23,052
Accrued risk reserves, less current portion	67,972	65,866
Refundable entrance fees	8,668	8,827
Obligation to provide future services	2,887	2,887
Deferred income taxes	18,648	18,376
Other noncurrent liabilities	14,703	15,795
Deferred revenue	3,892	3,226
Total liabilities	363,450	393,094
Equity:		
Common stock, $.01 par value; 45,000,000 shares authorized; 15,225,654 and 15,212,133 shares, respectively, issued and outstanding	152	152
Capital in excess of par value	217,657	215,659
Retained earnings	505,906	419,423
Accumulated other comprehensive income (loss)	(3,692)	67,504
Total National HealthCare Corporation stockholders' equity	720,023	702,738
Noncontrolling interest	1,195	694
Total equity	721,218	703,432
Total liabilities and equity	$1,084,668	$1,096,526

The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.

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NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Cash Flows

(unaudited – in thousands)

	Nine Months Ended September 30	
	2018	2017 *(as adjusted)*
Cash Flows From Operating Activities:		
Net income	$40,563	$34,386
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31,176	31,609
Equity in (earnings) losses of unconsolidated investments	1,860	(5,908)
Distributions from unconsolidated investments	3,830	7,748
Unrealized gains on marketable equity securities	(417)	–
Gains on sale of restricted marketable debt securities	(18)	(255)
Gain on acquisition of equity method investment	(2,050)	–
Deferred income taxes	1,067	881
Stock–based compensation	1,538	1,263
Changes in operating assets and liabilities:		
Accounts receivable	613	2,273
Income tax receivable	3,262	(1,248)
Inventories	(437)	395
Prepaid expenses and other assets	(1,336)	(942)
Trade accounts payable	3,319	(3,857)
Accrued payroll	(8,615)	(10,326)
Amounts due to third party payors	207	3,630
Accrued risk reserves	2,668	4,375
Other current liabilities	262	7,086
Other noncurrent liabilities	(1,092)	(760)
Deferred revenue	666	645
Net cash provided by operating activities	77,066	70,995
Cash Flows From Investing Activities:		
Additions to property and equipment	(22,708)	(24,328)
Acquisition of equity method investment, net of cash acquired	(527)	–
Distributions from/(investments in) unconsolidated companies	376	(176)
Collections of notes receivable	1,180	3,970
Purchase of restricted marketable securities	(9,950)	(24,874)
Sale of restricted marketable securities	4,539	46,598

Net cash (used in) provided by investing activities	(27,090)	1,190
Cash Flows From Financing Activities:		
Principal payments on debt	(25,000)	–
Principal payments under capital lease obligations	(2,751)	(2,591)
Dividends paid to common stockholders	(22,214)	(20,943)
Issuance of common shares	1,327	1,627
Repurchase of common shares	(867)	–
Equity attributable to noncontrolling interest	–	970
Entrance fee refunds	(159)	(1,097)
Net cash used in financing activities	(49,664)	(22,034)
Net Increase in Cash, Cash Equivalents, Restricted Cash, and Restricted Cash Equivalents	312	50,151
Cash, Cash Equivalents, Restricted Cash, and Restricted Cash Equivalents, Beginning of Period	67,421	31,589
Cash, Cash Equivalents, Restricted Cash, and Restricted Cash Equivalents, End of Period	$67,733	$81,740
Balance Sheet Classifications:		
Cash and cash equivalents	$55,599	$69,790
Restricted cash and cash equivalents	12,134	11,950
Total Cash, Cash Equivalents, Restricted Cash, and Restricted Cash Equivalents	$67,733	$81,740

The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.

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NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Stockholders' Equity

(in thousands, except share and per share amounts)

(unaudited)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total Stockholders' Equity
	Shares	Amount					
Balance at January 1, 2017	15,162,938	$ 152	$ 211,457	$ 391,934	$ 66,068	$ –	$ 669,611
Net income attributable to National HealthCare Corporation	–	–	–	34,735	–	–	34,735
Net loss attributable to noncontrolling interest	–	–	–	–	–	(349)	(349)
Equity contributed by noncontrolling interest	–	–	–	–	–	970	970
Other comprehensive income	–	–	–	–	5,051	–	5,051
Stock–based compensation	–	–	1,263	–	–	–	1,263
Shares sold – options exercised	33,917	–	1,627	–	–	–	1,627
Dividends declared to common stockholders ($1.41 per share)	–	–	–	(21,419)	–	–	(21,419)
Balance at September 30, 2017	15,196,855	$ 152	$ 214,347	$ 405,250	$ 71,119	$ 621	$ 691,489
Balance at January 1, 2018	15,212,133	$ 152	$ 215,659	$ 419,423	$ 67,504	$ 694	$ 703,432
Reclassification due to new accounting standards	–	–	–	68,201	(68,201)	–	–
Net income attributable to National HealthCare Corporation	–	–	–	40,812	–	–	40,812
Net loss attributable to noncontrolling interest	–	–	–	–	–	(249)	(249)
Equity contributed by noncontrolling interest	–	–	–	–	–	750	750
Other comprehensive loss	–	–	–	–	(2,995)	–	(2,995)
Stock–based compensation	–	–	1,538	–	–	–	1,538
Shares sold – options exercised	28,027	–	1,327	–	–	–	1,327
Repurchase of common shares	(14,506)	–	(867)	–	–	–	(867)
	–	–	–	(22,530)	–	–	(22,530)

Dividends declared to common stockholders ($1.48 per share)							
Balance at September 30, 2018	15,225,654	$ 152	$ 217,657	$ 505,906	$ (3,692)	$ 1,195	$ 721,218

The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.

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NATIONAL HEALTHCARE CORPORATION

Notes to Interim Condensed Consolidated Financial Statements

September 30, 2018

(unaudited)

Note 1 – Description of Business

National HealthCare Corporation ("NHC" or the "Company") is a leading provider of senior health care services. As of September 30, 2018, we operate or manage, through certain affiliates, 76 skilled nursing facilities with a total of 9,604 licensed beds, 24 assisted living facilities, five independent living facilities, one geriatric psychiatric hospital, and 35 homecare programs. We operate specialized care units within certain of our healthcare centers such as Alzheimer's disease care units and sub-acute nursing units. We also have a noncontrolling ownership interest in a hospice care business that services NHC owned skilled nursing facilities and others. In addition, we provide insurance services, management and accounting services, and we lease properties to operators of skilled nursing facilities. We operate in 10 states and are located primarily in the southeastern United States.

Note 2 – Summary of Significant Accounting Policies

The listing below is not intended to be a comprehensive list of all our significant accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles, with limited need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. See our audited December 31, 2017 consolidated financial statements and notes thereto which contain accounting policies and other disclosures required by generally accepted accounting principles. Our audited December 31, 2017 consolidated financial statements are available at our web site: www.nhccare.com.

Basis of Presentation

The unaudited interim condensed consolidated financial statements to which these notes are attached include all normal, recurring adjustments which are necessary to fairly present the financial position, results of operations and cash flows of NHC. All significant intercompany transactions and balances have been eliminated in consolidation. The consolidated financial statements include the accounts of all entities controlled by NHC. The Company presents noncontrolling interest within the equity section of its consolidated balance sheets. The Company presents the amount of consolidated net income that is attributable to NHC and the noncontrolling interest in its consolidated statements of operations.

We assume that users of these interim condensed consolidated financial statements have read or have access to the audited December 31, 2017 consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnotes and other disclosures which would substantially duplicate the disclosure contained in our most recent annual report to stockholders have been omitted. This interim financial information is not necessarily indicative of the results that may be expected for a full year for a variety of reasons.

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and could cause our reported net income to vary significantly from period to period.

Recently Adopted Accounting Guidance

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014–09 "Revenue from Contracts with Customers," also known as the "New Revenue Standard." This update is the result of a collaborative effort by the FASB and the International Accounting Standards Board to simplify revenue recognition guidance, remove inconsistencies in the application of revenue recognition, and to improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to receive for those goods or services. The New Revenue Standard is applied through the following five-step process:

1. Identify the contract(s) with a customer.

2. Identify the performance obligation in the contract.

3. Determine the transaction price.

4. Allocate the transaction price to the performance obligations in the contract.

5. Recognize revenue when (or as) the entity satisfies a performance obligation.

For a public entity, this update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period by applying either the full retrospective method or the cumulative catch-up transition method.

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On January 1, 2018, the Company adopted the provisions of ASU No. 2014-09 using the full retrospective method, which requires us to restate each prior reporting period presented. The most significant impact to NHC relates to the recording of revenue for patients that have individual copayment responsibilities and are eligible for both Medicare and Medicaid benefits (also known as dual eligible patients). As such with these patients, net patient revenues will only include the amounts expected to be collected from the patients in accordance with ASU No. 2014-09. Under the prior accounting guidance, we recorded the price stated in the contract as net patient revenue, and the amounts not collected from our patients were recorded as bad debts in other operating expenses. The adoption of ASU No. 2014-09 has no impact on the Company's accounts receivable as it was historically recorded net of allowance for doubtful accounts and contractual adjustments. The following tables present the effect on the interim condensed consolidated statements of operations for the three months and nine months ended September 30, 2017 for the accounting change that was retrospectively adopted on January 1, 2018:

Consolidated Statements of Operations

(*in thousands*)

	Three Months Ended September 30, 2017		
	As Previously Reported	Effect of Accounting Change	As Adjusted
Net patient revenues	$230,048	$ (789)	$229,259
Net operating revenues	241,985	(789)	241,196
Other operating expenses	64,039	(789)	63,250
Total costs and expenses	232,200	(789)	231,411
Net income	$11,184	$ –	$11,184

	Nine Months Ended September 30, 2017		
	As Previously Reported	Effect of Accounting Change	As Adjusted
Net patient revenues	$685,854	$ (2,256)	$683,598
Net operating revenues	720,685	(2,256)	718,429
Other operating expenses	190,778	(2,256)	188,522
Total costs and expenses	682,898	(2,256)	680,642
Net income	$34,386	$ –	$34,386

In January 2016, the FASB issued ASU No. 2016–01, “Financial Instruments – Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825).” ASU No. 2016–01 revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. ASU No. 2016–01 requires the change in fair value of many equity investments to be recognized in net income. On January 1, 2018, the Company adopted the provisions of ASU No. 2016-01 using the modified retrospective method as required by the standard. The adoption of ASU No. 2016-01 resulted in a $68,073,000 reclassification of net unrealized gains from accumulated other comprehensive income (“AOCI”) to the opening balance of retained earnings. For the three months and nine months ended September 30, 2018, the Company recognized a gain of $3,486,000 and $417,000, respectively, in our interim condensed consolidated statement of operations related to the change in fair value of our marketable equity securities. The adoption of ASU No. 2016-01 increases the volatility of other income due to the market fluctuation of our marketable equity securities.

In August 2016, the FASB issued ASU No. 2016-15, “Clarification on Classification of Certain Cash Receipts and Cash Payments on the Statements of Cash Flows.” ASU No. 2016-15 was issued to create consistency in the classification of eight specific cash flow items and provides an accounting policy election for classifying distributions received from equity method investments. Such equity method investment distributions are now classified using a 1) cumulative earnings approach, or 2) nature of distribution approach. On January 1, 2018, the Company adopted the provisions of ASU No. 2016-15 and this standard did not have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting.” ASU No. 2017-09 amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Accounting Standards Codification ("ASC") 718. On January 1, 2018, the Company adopted the provisions of ASU No. 2017-09 and this standard did not have a material impact on our consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, “Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU No. 2018-02 permits a company to reclassify disproportionate tax effects in accumulated other comprehensive income caused by the Tax Cuts and Jobs Act of 2017 to retained earnings. The FASB refers to these amounts as “stranded tax effects.” On January 1, 2018, the Company early adopted the provisions of ASU No. 2018-02. The adoption of this standard resulted in an adjustment of accumulated other comprehensive income, with a corresponding adjustment to the opening balance of retained earnings in the amount of $128,000, related to the stranded tax effects of the unrealized losses in our restricted marketable debt securities.

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Recent Accounting Guidance Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." The objective of this update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods and is to be applied utilizing a modified retrospective approach. We anticipate this standard will have a material impact on our consolidated financial statements and will result in an increase to total assets and total liabilities. Additionally, we are currently evaluating the impact this standard will have on our policies and procedures and internal control framework.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments." ASU No. 2016-13 replaces the current incurred loss impairment methodology for credit losses with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods, with early adoption permitted for fiscal years beginning after December 15, 2018. We are currently evaluation the impact this standard will have on our policies and procedures and internal control framework.

Segment Reporting

In accordance with the provisions of ASC 280, “Segment Reporting”, the Company is required to report financial and descriptive information about its reportable operating segments. The Company has two reportable operating segments: (1) inpatient services, which includes the operation of skilled nursing facilities and assisted and independent living facilities, and (2) homecare services. The Company also reports an “all other” category that includes revenues from rental income, management and accounting services fees, insurance services, and costs of the corporate office. See Note 6 for further disclosure of the Company’s operating segments.

Other Operating Expenses

Other operating expenses include the costs of care and services that we provide to the residents of our facilities and the costs of maintaining our facilities. Our primary patient care costs include drugs, medical supplies, purchased professional services, food, and professional liability insurance and licensing fees. The primary facility costs include utilities and property insurance.

General and Administrative Costs

With the Company being a healthcare provider, the majority of our expenses are "cost of revenue" items. Costs that could be classified as "general and administrative" by the Company would include its corporate office costs, excluding stock-based compensation, which were $7,805,000 and $21,056,000 for the three months and nine months ended September 30, 2018, respectively. General and administrative costs were $7,180,000 and $22,442,000 for the three months and nine months ended September 30, 2017, respectively.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided by the straight-line method over the expected useful lives of the assets estimated as follows: buildings and improvements, 20-40 years and equipment and furniture, 3-15 years. Leasehold improvements are amortized over periods that do not exceed the non-cancelable respective lease terms using the straight-line method.

Capital leases are recorded at the lower of fair market value or the present value of future minimum lease payments. Capital leases are amortized in accordance with the provision codified within Accounting Standards Codification ("ASC") Subtopic 840-30, *Leases – Capital Leases*. Amortization of capital lease assets is included in depreciation and amortization expense.

Accrued Risk Reserves

We are self–insured for risks related to health insurance and have wholly–owned limited purpose insurance companies that insure risks related to workers' compensation and general and professional liability insurance claims. The accrued risk reserves include a liability for reported claims and estimates for incurred but unreported claims. Our policy is to engage an external, independent actuary to assist in estimating our exposure for claims obligations (for both asserted and unasserted claims). We reassess our accrued risk reserves on a quarterly basis.

Professional liability remains an area of particular concern to us. The long-term care industry has seen an increase in personal injury/wrongful death claims based on alleged negligence by skilled nursing facilities and their employees in providing care to residents. As of September 30, 2018, we and/or our managed centers are defendants in 65 such claims. It remains possible that those pending matters plus potential unasserted claims could exceed our reserves, which could have a material adverse effect on our consolidated financial position, results of operations and cash flows. It is also possible that future events could cause us to make significant adjustments or revisions to these reserve estimates and cause our reported net income to vary significantly from period to period.

We are principally self-insured for incidents occurring in all centers owned or leased by us. The coverages include both primary policies and excess policies. In all years, settlements, if any, in excess of available insurance policy limits and our own reserves would be expensed by us.

Continuing Care Contracts and Refundable Entrance Fee

We have one Continuing Care Retirement Community (”CCRC”) within our operations. Residents at this retirement center may enter into continuing care contracts with us. The contracts provide that 10% of the resident entry fee becomes non-refundable upon occupancy, and the remaining refundable portion of the entry fee is calculated using the lessor of the price at which the apartment is re-assigned or 90% of the original entry fee, plus 40% of any appreciation if the apartment exceeds the original resident’s entry fee.

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Non-refundable fees are included as a component of the transaction price and are amortized into revenue over the actuarially determined remaining life of the resident, which is the expected period of occupancy by the resident. We pay the refundable portion of our entry fees to residents when they relocate from our community and the apartment is re-occupied. Refundable entrance fees are not included as part of the transaction price and are classified as non-current liabilities in the Company's consolidated balance sheets. The balances of refundable entrance fees as of September 30, 2018 and December 31, 2017 were $8,668,000 and $8,827,000, respectively.

Obligation to Provide Future Services

We annually estimate the present value of the cost of future services and the use of facilities to be provided to the current CCRC residents and compare that amount with the balance of non-refundable deferred revenue from entrance fees received. If the present value of the cost of future services exceeds the related anticipated revenues, a liability is recorded (obligation to provide future services) with a corresponding charge to income. As of September 30, 2018, and December 31, 2017, we have recorded a future service obligation in the amount of $2,887,000.

Other Noncurrent Liabilities

Other noncurrent liabilities include reserves primarily related to various uncertain income tax positions.

Deferred Revenue

Deferred revenue includes the deferred gain on the sale of assets to National Health Corporation (“National”), the non-refundable portion (10%) of CCRC entrance fees being amortized over the remaining life expectancies of the residents, and premiums received within our workers’ compensation and professional liability companies that are not yet earned.

Noncontrolling Interest

The noncontrolling interest in a subsidiary is presented within total equity in the Company's interim condensed consolidated balance sheets. The Company presents the noncontrolling interest and the amount of consolidated net income attributable to NHC in its interim condensed consolidated statements of operations. The Company’s earnings per share is calculated based on net income attributable to NHC’s stockholders. The carrying amount of the noncontrolling interest is adjusted based on an allocation of subsidiary earnings based on ownership interest.

Variable Interest Entities

We have equity interests in unconsolidated limited liability companies that operate various post-acute and senior healthcare businesses. We analyze our investments in these limited liability companies to determine if the company is considered a variable interest entity ("VIE") and would require consolidation. To the extent that we own interests in a VIE and we (i) are the sole entity that has the power to direct the activities of the VIE and (ii) have the obligation or rights to absorb the VIE's losses or receive its benefits, then we would be determined to be the primary beneficiary and would consolidate the VIE. To the extent we own interests in a VIE, then at each reporting period, we re-assess our conclusions as to which, if any, party within the VIE is considered the primary beneficiary.

The Company's maximum exposure to losses in its investments in unconsolidated VIEs cannot be quantified and may or may not be limited to its investment in the unconsolidated VIE. The investments in unconsolidated VIEs are classified as "investments in limited liability companies" in the consolidated balance sheets.

Prior Period Classifications

Certain amounts in prior periods have been reclassified to conform with current period presentation.

Note 3 – Net Patient Revenues

Net patient revenues are derived from services rendered to patients for skilled and intermediate nursing, rehabilitation therapy, assisted living and independent living, and home health care services. Net patient revenue is reported at the amount that reflects the consideration to which the Company expects to be entitled in exchange for providing patient services. These amounts are due from patients, governmental programs, and other third-party payors, and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations.

The Company disaggregates revenue from contracts with customers by service type and by payor.

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Revenue by Service Type

The Company's net patient services can generally be classified into the following two categories: (1) inpatient services, which includes the operation of skilled nursing facilities and assisted and independent living facilities, and (2) homecare services.

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
(in thousands)	2018	2017	2018	2017
Net patient revenues:				
Inpatient services	$220,099	$213,814	$652,066	$636,311
Homecare	14,728	15,445	45,107	47,287
Total net patient revenue	$234,827	$229,259	$697,173	$683,598

The Company recognizes revenue as its performance obligations are completed. The performance obligations are satisfied over time as the patient simultaneously receives and consumes the benefits of the healthcare services provided. For inpatient services, revenue is recognized on a daily basis as each day represents a separate contract and performance obligation. For homecare, revenue is recognized when services are provided based on the number of days of service rendered in the episode or on a per-visit basis. Typically, patients and third-party payors are billed monthly after services are performed or the patient is discharged and payments are due based on contract terms.

As our performance obligations relate to contracts with a duration of one year or less, the Company has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The Company has minimal unsatisfied performance obligations at the end of the reporting period as our patients are typically under no obligation to remain admitted in our facilities or under our care.

As the period between the time of service and time of payment is typically one year or less, the Company elected as a practical expedient under ASC 606-10-32-18 to not adjust for the effects of a significant financing component.

Revenue by Payor

Certain groups of patients receive funds to pay the cost of their care from a common source. The following table sets forth sources of net patient revenues for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
Source	2018	2017	2018	2017
Medicare	34 %	34 %	35 %	35 %
Managed Care	12 %	13 %	12 %	13 %
Medicaid	27 %	27 %	26 %	26 %
Private Pay and Other	27 %	26 %	27 %	26 %
Total	100 %	100 %	100 %	100 %

The Company determines the transaction price based on established billing rates reduced by contractual adjustments provided to third party payors. Contractual adjustments are based on contractual agreements and historical experience. The Company considers the patient's ability and intent to pay the amount of consideration upon admission. Subsequent changes resulting from a patient's ability to pay are recorded as bad debt expense, which is included as a component of other operating expenses in the interim condensed consolidated statements of operations. The provision for doubtful accounts was $1,098,000 and $3,121,000 for the three months and nine months ended September 30, 2018, respectively. The provision for doubtful accounts was $982,000 and $3,215,000 for the three months and nine months ended September 30, 2017, respectively.

Medicare covers skilled nursing services for beneficiaries who require nursing care and/or rehabilitation services following a hospitalization of at least three consecutive days. For each eligible day a Medicare beneficiary is in a skilled nursing facility, Medicare pays the facility a daily payment, subject to adjustment for certain factors such as a wage index in the geographic area. The payment covers all services provided by the skilled nursing facility for the beneficiary that day, including room and board, nursing, therapy and drugs, as well as an estimate of capital–related costs to deliver those services.

For homecare services, Medicare pays based on the acuity level of the patient and based on episodes of care. An episode of care is defined as a length of care up to 60 days with multiple continuous episodes allowed. The services covered by the episode payment include all disciplines of care, in addition to medical supplies, within the scope of the home health benefit. We are allowed to make a request for anticipated payment at the start of care equal to 60% of the expected payment for the initial episode. The remaining balance due is paid following the submission of the final claim at the end of the episode. Deferred revenue is recorded for payments received for which the related services have not yet been provided

Medicaid is operated by individual states with the financial participation of the federal government. The states in which we operate currently use prospective cost–based reimbursement systems. Under cost–based reimbursement systems, the skilled nursing facility is reimbursed for the reasonable direct and indirect allowable costs it incurred in a base year in providing routine resident care services as defined by the program.

Private pay, managed care, and other payment sources include commercial insurance, individual patient funds, managed care plans and the Veterans Administration. Private paying patients, private insurance carriers and the Veterans Administration generally pay based on the healthcare facilities charges or specifically negotiated contracts. For private pay patients in skilled nursing, assisted living and independent living facilities, the Company bills for room and board charges, with the remittance being due on receipt of the statement and generally by the 10th day of the month the services are performed.

Certain managed care payors for homecare services pay on a per-visit basis. This non-episodic based revenue is recorded on an accrual basis based upon the date of services at amounts equal to its established or estimated per-visit rates.

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Third Party Payors

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Noncompliance with such laws and regulations can be subject to regulatory actions including fines, penalties, and exclusion from the Medicare and Medicaid programs. We believe that we are in compliance with all applicable laws and regulations.

Medicare and Medicaid program revenues, as well as certain Managed Care program revenues, are subject to audit and retroactive adjustment by government representatives or their agents. The Medicare PPS methodology requires that patients be assigned to Resource Utilization Groups ("RUGs") based on the acuity level of the patient to determine the amount paid to us for patient services. The assignment of patients to the various RUG categories is subject to post–payment review by Medicare intermediaries or their agents. Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Company's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known, or as years are settled or are no longer subject to such audits, reviews, and investigations. We believe currently that any differences between the net revenues recorded and final determination will not materially affect the consolidated financial statements. We have made provisions of approximately $17,596,000 and $17,389,000 as of September 30, 2018 and December 31, 2017, respectively, for various Medicare, Medicaid, and Managed Care claims reviews and current and prior year cost reports.

Note 4 – Other Revenues

Revenues from rental income include health care real estate properties owned by us and leased to third party operators. Revenues from management and accounting services fees are generated by providing management and accounting services to third-party post-acute healthcare facilities. Revenues from insurance services include premiums for workers' compensation and professional liability insurance policies that our wholly–owned insurance subsidiaries have written for third-party post-acute health care facilities to which we provide management or accounting services. "Other" revenues include miscellaneous health care related earnings.

Other revenues include the following:

(in thousands)	Three Months Ended September 30 2018	2017	Nine Months Ended September 30 2018	2017
Rental income	$5,548	$5,500	$16,633	$16,501
Management and accounting services fees	3,818	4,130	11,265	11,741
Insurance services	1,716	2,077	5,362	5,721
Other	417	230	996	868
Total other revenues	$11,499	$11,937	$34,256	$34,831

Management Fees from National

We manage five skilled nursing facilities owned by National. For the three months and nine months ended September 30, 2018, we recognized management fees and interest on management fees of $1,087,000 and $3,140,000 from these centers, respectively. For the three months and nine months ended September 30, 2017, we recognized management fees and interest on management fees of $977,000 and $2,902,000 for these centers.

Insurance Services

For workers' compensation insurance services, the premium revenues reflected in the interim condensed consolidated statements of operations for the three months and nine months ended September 30, 2018 were $1,043,000 and $3,342,000, respectively. For the three months and nine months ended September 30, 2017, the workers' compensation premium revenues reflected in the interim condensed consolidated statements of operations were $1,399,000 and $4,087,000. Associated losses and expenses are reflected in the interim condensed consolidated statements of operations as "Salaries, wages and benefits."

For professional liability insurance services, the premium revenues reflected in the interim condensed consolidated statements of operations for the three months and nine months ended September 30, 2018 were $673,000 and $2,020,000, respectively. For professional liability insurance services, the premium revenues reflected in the interim condensed consolidated statements of operations for the three months and nine months ended September 30, 2017 were $678,000 and $1,634,000, respectively. Associated losses and expenses including those for self–insurance are included in the interim condensed consolidated statements of operations as "Other operating costs and expenses".

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Note 5 – Non–Operating Income

Non–operating income includes equity in earnings of unconsolidated investments, dividends and other realized gains and losses on marketable securities, interest income, and gain on acquisition of additional interest of a geriatric psychiatry partnership.

Our most significant equity method investment is a 75.1% non–controlling ownership interest in Caris HealthCare L.P. (“Caris”), a business that specializes in hospice care services. For the nine months ended September 30, 2018, Caris recorded expenses of $8,364,000 for the settlement of their Qui Tam legal matter, all of which were incurred during the first two quarters of the year. Please see Note 15 – *Contingencies and Commitments* for further detail describing the Caris’ legal investigation and settlement.

	Three Months Ended September 30		Nine Months Ended September 30	
(in thousands)	2018	2017	2018	2017
Equity in earnings/(losses) of unconsolidated investments	$2,724	$2,528	$(1,860)	$5,908
Dividends and net realized gains on sales of securities	1,777	1,696	5,374	5,319
Interest income	1,916	1,866	5,492	4,820
Gain on acquisition of equity method investment	2,050	–	2,050	–
Total non-operating income	$8,467	$6,090	$11,056	$16,047

Gain on acquisition of equity method investment

On July 20, 2018, the Company expanded its operations through an acquisition of additional ownership resulting in a controlling financial interest of a 14-bed geriatric psychiatric hospital in Osage Beach, Missouri. We previously held a noncontrolling interest and accounted for the hospital as an equity method investment. The operating results of the business have been included in the accompanying interim condensed consolidated financial statements since the controlling interest acquisition date.

Upon acquiring a controlling financial interest in the investee, the Company fair valued its previously held equity interest as of the acquisition date. This remeasurement of our equity interest at fair value resulted in a gain of $2,050,000 during the third quarter of 2018. The gain was recorded in "Non-operating income" in the interim condensed consolidated statement of operations. Additionally, the excess of the fair value over the amounts assigned to the assets and liabilities of the investee resulted in goodwill in the amount of $3,395,000.

Note 6 – Business Segments

The Company has two reportable operating segments: (1) inpatient services, which includes the operation of skilled nursing facilities, assisted and independent living facilities, and our geriatric psychiatric hospital; (2) homecare services. These reportable operating segments are consistent with information used by the Company's Chief Executive Officer, as chief operating decision maker ("CODM"), to assess performance and allocate resources.

The Company also reports an "all other" category that includes revenues from rental income, management and accounting services fees, insurance services, and costs of the corporate office. For additional information on these reportable segments see Note 2 - *Summary of Significant Accounting Policies.*

The Company's CODM evaluates performance and allocates capital resources to each segment based on an operating model that is designed to improve the quality of patient care and profitability of the Company while enhancing long-term shareholder value. The CODM does not review assets by segment in his resource allocation and therefore, assets by segment are not disclosed below.

The following table sets forth the Company's unaudited interim condensed consolidated statements of operations by business segment *(in thousands)*:

	Three Months Ended September 30, 2018			
	Inpatient Services	Homecare	All Other	Total
Revenues:				
Net patient revenues	$220,099	$ 14,728	$–	$234,827
Other revenues	136	–	11,363	11,499
Net operating revenues	220,235	14,728	11,363	246,326
Costs and expenses:				
Salaries, wages and benefits	131,418	8,367	9,403	149,188
Other operating	57,371	4,797	2,339	64,507
Rent	8,255	488	1,447	10,190
Depreciation and amortization	9,570	55	812	10,437
Interest	369	–	801	1,170
Total costs and expenses	206,983	13,707	14,802	235,492

Income (loss) from operations	13,252	1,021	(3,439)	10,834
Non-operating income	–	–	8,467	8,467
Unrealized gains on marketable equity securities	–	–	3,486	3,486
Income before income taxes	$13,252	$ 1,021	$8,514	$22,787

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(As adjusted)	Three Months Ended September 30, 2017 Inpatient Services	Homecare	All Other	Total
Revenues:				
Net patient revenues	$213,814	$ 15,445	$–	$229,259
Other revenues	181	–	11,756	11,937
Net operating revenues	213,995	15,445	11,756	241,196
Costs and expenses:				
Salaries, wages and benefits	128,403	8,318	9,179	145,900
Other operating	56,062	5,291	1,897	63,250
Rent	8,128	502	1,476	10,106
Depreciation and amortization	9,756	41	1,036	10,833
Interest	423	–	899	1,322
Total costs and expenses	202,772	14,152	14,487	231,411
Income (loss) from operations	11,223	1,293	(2,731)	9,785
Non-operating income	–	–	6,090	6,090
Income before income taxes	$11,223	$ 1,293	$3,359	$15,875

	Nine Months Ended September 30, 2018 Inpatient Services	Homecare	All Other	Total
Revenues:				
Net patient revenues	$652,066	$ 45,107	$–	$697,173
Other revenues	588	–	33,668	34,256
Net operating revenues	652,654	45,107	33,668	731,429
Costs and expenses:				
Salaries, wages and benefits	382,913	25,009	26,827	434,749
Other operating	171,275	14,816	6,177	192,268
Rent	24,780	1,460	4,451	30,691
Depreciation and amortization	28,602	137	2,437	31,176
Interest	1,149	-	2,514	3,663
Total costs and expenses	608,719	41,422	42,406	692,547
Income (loss) from operations	43,935	3,685	(8,738)	38,882
Non-operating income	–	–	11,056	11,056
Unrealized gains on marketable equity securities	–	–	417	417

Income before income taxes	$43,935	$ 3,685	$2,735	$50,355

	Nine Months Ended September 30, 2017			
(As adjusted)	Inpatient Services	Homecare	All Other	Total
Revenues:				
Net patient revenues	$636,311	$ 47,287	$–	$683,598
Other revenues	631	–	34,200	34,831
Net operating revenues	636,942	47,287	34,200	718,429
Costs and expenses:				
Salaries, wages and benefits	373,641	24,760	28,238	426,639
Other operating	167,454	15,484	5,584	188,522
Rent	24,552	1,490	4,231	30,273
Depreciation and amortization	28,362	120	3,127	31,609
Interest	1,309	–	2,290	3,599
Total costs and expenses	595,318	41,854	43,470	680,642
Income (loss) from operations	41,624	5,433	(9,270)	37,787
Non-operating income	–	–	16,047	16,047
Income before income taxes	$41,624	$ 5,433	$6,777	$53,834

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Note 7 – Long-Term Leases

Capital Leases

Fixed assets recorded under the capital leases, which are included in property and equipment in the interim condensed consolidated balance sheets, are as follows:

	September 30, 2018	December 31, 2017
	(in thousands)	
Buildings and personal property	$39,032	$39,032
Accumulated amortization	(17,989)	(15,045)
	$21,043	$23,987

Operating Leases

The Company leases from National Health Investors, Inc. (“NHI”) the real property of 35 skilled nursing facilities, seven assisted living facilities and three independent living facilities under two separate lease agreements. Base rent expense under both lease agreements totals $34,200,000 annually with rent thereafter escalating by 4% of the increase in facility revenue over the base year. Total facility rent expense to NHI was $9,478,000 and $9,314,000 for the three months ended September 30, 2018 and 2017, respectively. Total facility rent expense to NHI was $28,434,000 and $27,942,000 for the nine months ended September 30, 2018 and 2017, respectively.

Minimum Lease Payments

The approximate future minimum lease payments required under all leases that have remaining non-cancelable lease terms at September 30, 2018 are as follows:

	Operating Leases	Capital Leases

	(in thousands)	
2019	$34,200	$5,200
2020	34,200	5,200
2021	34,200	5,200
2022	34,200	5,200
2023	34,200	5,200
Thereafter	116,900	2,167
Total minimum lease payments	$287,900	$28,167
Less: Amounts representing interest		(4,170)
Present value of minimum lease payments		23,997
Less: Current portion		(3,865)
Long-term capital lease obligations		$20,132

Note 8 – Earnings per Share

Basic net income per share is computed based on the weighted average number of common shares outstanding for each period presented. Diluted net income per share reflects the potential dilution that would have occurred if securities to issue common stock were exercised, converted, or resulted in the issuance of common stock that would have then shared in our earnings.

The following table summarizes the earnings and the weighted average number of common shares used in the calculation of basic and diluted earnings per share *(in thousands, except for share and per share amounts)*:

	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Basic:				
Weighted average common shares outstanding	15,225,654	15,195,394	15,221,217	15,186,315
Net income attributable to National HealthCare Corporation	$21,142	$11,352	$40,812	$34,735
Earnings per common share, basic	$1.39	$0.75	$2.68	$2.29
Diluted:				
Weighted average common shares outstanding	15,225,654	15,195,394	15,221,217	15,186,315
Dilutive effect of stock options	16,432	25,173	9,475	31,482
Weighted average common shares outstanding	15,242,086	15,220,567	15,230,692	15,217,797
Net income attributable to National HealthCare Corporation	$21,142	$11,352	$40,812	$34,735
Earnings per common share, diluted	$1.39	$0.75	$2.68	$2.28

In the above table, options to purchase 1,048,275 and 1,122,585 shares of our common stock have been excluded for the quarter ended and nine-months ended September 30, 2018 and 2017, respectively, due to their anti–dilutive impact.

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Note 9 – Investments in Marketable Securities

Our investments in marketable equity securities are carried at fair value with the changes in unrealized gains and losses recognized in our results of operations at each measurement date. Our investments in marketable debt securities are classified as available for sale securities and carried at fair value with the unrealized gains and losses recognized through accumulated other comprehensive income at each measurement date. Realized gains and losses from securities sales are recognized in results of operations upon disposition of the securities using the specific identification method on a trade date basis. Refer to Note 10 - *Fair Value Measurements* for a description of the Company's methodology for determining the fair value of marketable securities.

Marketable securities and restricted marketable securities consist of the following *(in thousands)*:

	September 30, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investments available for sale:				
Marketable equity securities	$30,176	$139,502	$30,176	$139,085
Restricted investments available for sale:				
Corporate debt securities	67,905	66,190	65,107	65,461
Commercial mortgage–backed securities	57,626	56,293	54,030	53,544
U.S. Treasury securities	23,497	22,540	21,685	21,172
State and municipal securities	23,679	23,011	26,455	26,218
	$202,883	$307,536	$197,453	$305,480

Included in the marketable equity securities are the following *(in thousands, except share amounts):*

September 30, 2018	December 31, 2017
Shares Cost &n	